

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION**

In re:)	
)	
JEFFERSON COUNTY, ALABAMA,)	Case No. 11-05736-TBB-9
)	
)	Chapter 9
)	
Debtor.)	
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**RESPONSE AND MEMORANDUM OF SUPPLEMENTAL POINTS OF SYNCORA
GUARANTEE INC. IN SUPPORT OF: (I) EMERGENCY MOTION OF THE
JEFFERSON COUNTY SEWER SYSTEM RECEIVER FOR (A) A DETERMINATION
THAT THE RECEIVER SHALL CONTINUE TO OPERATE AND ADMINISTER THE
SEWER SYSTEM PURSUANT TO THE RECEIVER ORDER OR (B) FOR THE
RELIEF FROM AUTOMATIC STAY OR OTHER APPROPRIATE RELIEF; AND (II)
EXPEDITED MOTION OF INDENTURE TRUSTEE FOR JEFFERSON COUNTY’S
SEWER WARRANTS FOR (A) THE COURT TO ABSTAIN FROM TAKING ANY
ACTION TO INTERFERE WITH THE RECEIVERSHIP CASE AND THE
RECEIVER’S OPERATION AND ADMINISTRATION OF THE SEWER SYSTEM IN
ACCORDANCE WITH THE RECEIVERSHIP ORDER, OR (B) FOR RELIEF FROM
THE AUTOMATIC STAY TO THE EXTENT NECESSARY TO ALLOW RECEIVER
TO CONTINUE TO OPERATE AND ADMINISTER THE SEWER SYSTEM UNDER
THE RECEIVERSHIP ORDER, AND (C) REQUEST FOR AN EXPEDITED HEARING**

Syncora Guarantee Inc. (“Syncora”) respectfully submits this response and memorandum of supplemental points (“Response”) in support of the relief requested in (i) Emergency Motion of the Jefferson County Sewer System Receiver for (A) A Determination that the Receiver Shall Continue to Operate and Administer the Sewer System Pursuant to the Receiver Order or (B) For Relief from Automatic Stay or Other Appropriate Relief (the “Receiver’s Motion”), and (ii) Expedited Motion of Indenture Trustee for Jefferson County’s Sewer Warrants for (A) The Court to Abstain from Taking Any Action to Interfere with the Receivership Case and the Receiver’s Operation and Administration of Sewer System in Accordance with the Receivership Order, or (B) For Relief from the Automatic Stay to the Extent Necessary to Allow Receiver to Continue

to Operate and Administer the Sewer System Under the Receivership Order, and (C) Request for Expedited Hearing (the “Trustee’s Motion” and with the Receiver’s Motion, the “Receivership Motions”).¹

I. SYNCORA’S STANDING AND SUPPLEMENTAL BACKGROUND²

1. Syncora (formerly known as XL Capital Assurance Inc.) is both a surety and insurer of warrants (the “Bonds”) issued by Jefferson County, Alabama (the “County”) between 1997 and 2003 for the purpose of funding improvements to the County’s sewer system (the “System”).³ Specifically, Syncora is (i) an insurer of (a) \$839,500,000 Sewer Revenue Refunding Bonds Series 2002-C (the “2002 Bonds”) pursuant to a Municipal Bond Insurance Policy, effective October 25, 2002 (the “2002 Policy”), and (b) \$300,000,000 Sewer Revenue Refunding Bonds Series 2003-B (the “2003 Bonds”) pursuant to a Municipal Bond Insurance Policy, effective May 1, 2003 (the “2003 Policy” and together with the 2002 Policy, the “Insurance Policies”), and (ii) a surety of the Bonds, including the 2002 and 2003 Bonds,

¹ Syncora submits this Response in accordance with the Court’s Scheduling Order, dated November 11, 2011 [Docket No. 98] (the “Scheduling Order”). By this Response, Syncora has endeavored to raise and supplement arguments relevant to the Receivership Motions but not duplicate the arguments set forth in the Receivership Motions, which Syncora supports/joins. Syncora is a “party in interest” in this case as a substantial secured creditor and wishes to appear and be heard at the hearing on the Receivership Motions, and incorporates the position espoused in Financial Guaranty Insurance Company’s Memorandum in Support of its Right to Appear and Be Heard at the Hearing on the Emergency Motions Filed by the Jefferson County Sewer System Receiver and Indenture Trustee. As required by the Scheduling Order, Syncora hereby provides notice that it does not expect to question witnesses at the hearing on the Receivership Motions, or to otherwise burden the Court with duplication at oral argument, but reserves its rights to be heard (and, if necessary and appropriate, subject to the Court’s discretion, cross-examine witnesses) in connection with this Response.

² Capitalized terms not otherwise defined herein shall have their meaning set forth in the Receiver’s Motion.

³ The Bonds were issued pursuant to a trust indenture, dated February 1, 1997 (the “Original Indenture” and together with any supplements or amendments thereto, the “Indenture”), between the County and AmSouth Bank of Alabama, under which The Bank of New York Mellon serves as the successor trustee to AmSouth Bank of Alabama (the “Trustee”). JPMorgan Securities, Inc. acted as the lead underwriter of the Bonds that were issued in 2002 and 2003.

pursuant to the Debt Service Reserve Insurance Policy, effective December 30, 2004 (the “Surety”).

2. Simultaneously with entering into the Surety, the County and Syncora entered into the Financial Guaranty Agreement, dated as of December 30, 2004 (the “FGA”). The FGA requires the County, among other things, to reimburse and indemnify Syncora for payments and losses, and provides Syncora with broad rights to pursue remedies in connection therewith. FGA § 4.02. The County also granted Syncora a security interest in any collateral, property, revenue, or other payments to the extent it grants any such security interests to the bondholders under the Indenture on a parity basis. FGA § 2.03; Original Indenture § 2.1.

3. In addition, as a result of draws made under the Insurance Policies arising from the County’s failure to make required principal and interest payments on the Bonds, Syncora acquired \$184 million of the Bonds (the “Replacement Warrants”) from certain liquidity banks. In connection with a settlement agreement, dated as of April 7, 2010 (the “Settlement Agreement”), among Syncora and certain liquidity banks party thereto (the “Liquidity Banks”), Syncora pledged certain of the Replacement Warrants to the Liquidity Banks in respect to certain payments owing under the Settlement Agreement. The Replacement Warrants, like the Bonds, are secured by a lien on the revenues generated by the System after payment of expenses incurred in its operation.

4. Syncora was also a plaintiff in the suit filed in September 2008 in the United States District Court for the Northern District of Alabama (the “Federal Court”) against the County and its then-serving commissioners (the “Federal Action”).⁴ Since the appointment of the Receiver, Syncora, acting in good faith, has engaged in negotiations with the Receiver, the

⁴ The case is styled *The Bank of New York Mellon v. Jefferson County, Alabama, et al.*, Case No. 2:08-CV-01703-RDP.

County, and numerous other creditors of the County in an attempt to adjust the debts of the County without the need for a bankruptcy filing, and the Receiver Order paved the way for such discussions.⁵

II. ARGUMENT

A. **REMOVAL OF THE RECEIVER WILL RENDER ANY PLAN OF ADJUSTMENT INCAPABLE OF MEETING THE “BEST INTEREST” TEST OF SECTION 943(b)(7) OF THE BANKRUPTCY CODE**

5. Much like a chapter 11 case, the ultimate goal of this case is confirmation of a plan that maximizes value for creditors. *See In re Connector 200 Ass’n, Inc.*, 447 B.R. 752, 765-66 (Bankr. D.S.C. 2011) (concluding that the proposed plan was in the best interest of the creditors because it afforded creditors the potential for the greatest return from the debtor’s assets, noting that the evidence submitted by the debtor regarding projected net revenues of a traffic project were reasonable and uncontroverted). If the Receiver, the embodiment of the creditors’ remedies already obtained under State law, is forced to turn over control of the System, its revenues, and the attendant rate-making authority to the County, any attempt by the County to file and confirm a plan of adjustment will be futile. As set forth below, the County will be unable to confirm a plan that complies with the “best interest of the creditors” test, as mandated under section 943(b)(7) of title 11 of the United States Code (the “Bankruptcy Code”).

6. Section 943(b) of the Bankruptcy Code sets forth the conditions for confirmation of a chapter 9 debtor’s plan of adjustment. 11 U.S.C. § 943(b)(1)-(7). The House Report makes

⁵ As evidenced by the County’s correspondence sent to the Receiver on the first day of this case, Syncora submits that the County’s real motive in filing this chapter 9 petition was to collaterally attack the Receiver’s authority, retarding all progress made by creditors to date, and not in furtherance of a good faith desire to effect a plan to adjust debts. *See* Letter from County counsel to Receiver counsel, dated November 9, 2011, which is attached to the Receiver’s Motion as Exhibit E (the “County Letter”), at 4 (“The protection afforded by the Bankruptcy Code’s automatic stay provisions was a material factor in the County’s decisions to file for Chapter 9.”). With respect to this and other issues relevant to the filing and administration of the chapter 9 case, Syncora reserves all of its rights and remedies.

clear that the provisions of section 943(b) are in fact “requirements” for confirmation. *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 363 (1977). The chapter 9 debtor bears the burden of satisfying section 943(b)’s confirmation requirements by a preponderance of the evidence. *In re Mount Carbon Metropolitan Dist.*, 242 B.R. 18, 31 (Bankr. D. Colo. 1999).

7. Among the enumerated requirements, the plan must be in the “best interest of creditors.” 11 U.S.C. § 943(b)(7). The “best interest of creditors” requirement of § 943(b)(7) is “generally regarded as requiring that a proposed plan provide ***a better alternative for creditors than what they already have.***” *In re Pierce County Hous. Auth.*, 414 B.R. 702, 718 (Bankr. W.D. Wash. 2009) (emphasis added). In a chapter 9 bankruptcy case, where the alternatives of chapter 7 liquidation or proposal of a competing plan are not available, the alternative available is dismissal of the case so that creditors can resort to remedies under State law. *In re Sanitary & Imp. Dist., No. 7*, 98 B.R. 970, 975 (Bankr. D. Neb. 1989).

8. Here, creditors already pursued and obtained remedies under State law. The County’s only option is to work from this *status quo* and develop a plan of adjustment based on what creditors “already have.” *Pierce County Hous. Auth.*, 414 B.R. at 718. By definition, the Court will be confronted with whether State law affords a result superior to any plan proposed in this case. The best interest of creditors test requires this State law remedy be respected, not thwarted, and two courts (one federal and one State) already have determined that creditors’ prospects are enhanced by appointment of the Receiver. The County’s goal to strip creditors of their State law rights only to propose a lesser alternative ensures only one result—dismissal of the case after protracted delay and expense. Moreover, any efforts to suppress rate increases (the primary motive of the County in taking control of the System) will be refuted by the same

evidence that the Federal Court and State Court already found persuasive.⁶ (*See, e.g.*, Memorandum Opinion at 18; Receiver Order ¶ 7 at 3.)⁷

B. CONTINUATION OF THE RECEIVERSHIP IS AN APPROPRIATE FORM OF ADEQUATE PROTECTION UNDER SECTION 361 OF THE BANKRUPTCY CODE

9. While joining in the Trustee’s argument that the County cannot adequately protect the secured parties’ interests in the System (*see* Trustee’s Motion at 33-36), Syncora writes to emphasize that, to the extent the automatic stay applies,⁸ not only are secured creditors (such as Syncora) entitled to adequate protection under the Bankruptcy Code, but that adequate protection is a flexible concept that can take the form of remedies other than those listed in section 361—including the continuation of the Receiver’s management of the System, control over System revenues, expenses, and rate-making authority.

⁶ As set forth in the Receiver’s Motion, the County never appealed the Receiver Order and this Court lacks authority to reverse that Order. As such, rate-making authority over the System resides exclusively in the Receiver until the State Court orders otherwise. This provides an additional reason why the County will be unable to confirm a plan of adjustment. Section 1129(a)(6) applies in chapter 9 cases. *See* 11 U.S.C. § 901(a). Section 1129(a)(6) provides that “[a]ny governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval” is a requirement for confirmation of a plan. 11 U.S.C. § 1129(a)(6). Here, it is the Receiver who will have jurisdiction to approve rate changes under or in connection with the plan. As such, the County will be unable to obtain rate changes without the consent of the Receiver. Syncora submits that the Receiver’s continued control over the System will ultimately result in compliance with this mandatory condition to confirmation.

⁷ The Memorandum Opinion, entered by the Federal Court on June 12, 2009 [Docket No. 100] in the Federal Action, is annexed to the Trustee’s Motion as Exhibit E. The Receiver Order is annexed to the Receiver’s Motion as Exhibit A.

⁸ “Property interests are determined under state law.” *Butner v. United States*, 440 U.S. 48, 55 (1979) (“Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.”) Pursuant to the Receiver Order, the Receiver was granted the “sole and exclusive right and authority to take complete and exclusive possession, control and custody of the System. . . .” (Receiver Order ¶ 2a.) As a result, it is questionable that the Receiver’s continued possession and control of the System concerns property of the debtor under section 902(1) in a manner that would implicate the automatic stay under section 362 of the Bankruptcy Code.

10. As an initial matter, “[sections] 361 and 362 of the Bankruptcy Code, which respectively define the concept of adequate protection and its application, are specifically incorporated into chapter 9 through [section] 901.” *In re County of Orange*, 179 B.R. 185, 190 (Bankr. C.D. Ca. 1995); *see also* 11 U.S.C. § 901(a). These sections afford creditors stayed from enforcing their interests with the *right* to adequate protection. *See* 3-361 COLLIER ON BANKRUPTCY ¶361.02 (“An entity is entitled to adequate protection ***as a matter of right, not merely as a matter of discretion*** . . . when the entity is stayed from enforcing its interest. . . .”) (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 340, 343-44 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 52-53 (1978)) (emphasis added).

11. Section 361 of the Bankruptcy Code outlines—in a non-exclusive manner—examples of different forms of adequate protection available to interest holders, and provides, in part, that when adequate protection is required under section 362 of the Bankruptcy Code, it may be provided by (i) periodic cash payments, (ii) additional or replacement liens, and (iii) such other relief as will result in the realization by such entity of the indubitable equivalent of its interest in the debtor’s property. *See* 11 U.S.C. § 361.

12. The Court has considerable flexibility in determining the appropriate form of adequate protection and the discretion to make case-by-case determinations. *See MBank Dallas, N.A. v. O’Connor (In re O’Connor)*, 808 F.2d 1393, 1396-97 (10th Cir. 1987) (adequate protection is a “concept which is to be decided flexibly on the proverbial ‘case-by-case’ basis”); *In re Briggs Transp. Comp.*, 780 F.2d 1339, 1350 (8th Cir. 1985) (noting courts exercise “maximum flexibility in structuring a debtor’s proposal for adequate protection” and “what constitutes adequate protection in a particular case is a question whose resolution is best left to the knowledge and expertise of the Bankruptcy Court”); *Bankers Life. Ins. Co. v. Alyucan*

Interstate Corp. (In re Alyucan Interstate Corp.), 12 B.R. 803, 813 (Bankr. D. Utah 1981) (“The facts of each case, thoughtfully weighed, not formularized, define adequate protection.”); COLLIER ¶ 363.05 (noting examples in section 361 of Bankruptcy Code of forms of adequate protection “are not intended to be limiting”).

13. While the Receiver’s continued management of the System, control over revenues, expenses, and rate-making authority may not present the typical form of adequate protection, consistent with the flexible nature of adequate protection described in section 361 of the Bankruptcy Code, courts have displayed a willingness to require analogous non-monetary forms of adequate protection. *See, e.g., In re Century Inv. Fund VIII Ltd. P’ship*, 155 B.R. 1002, 1008 (Bankr. E.D. Wis. 1989) *order reinstated sub nom. Matter of Century Inv. Fund VIII Ltd. P’ship*, 937 F.2d 371 (7th Cir. 1991) (appointing receiver to collect income and rents as adequate protection for mortgagee); *In re 5877 Poplar, L.P.*, 268 B.R. 140, 150 (Bankr. W.D. Tenn. 2001) (adequate protection included requirement that debtor turn over books and records, provide secured creditor with inspection rights, and reinvest revenues); *In re Heatron, Inc.*, 6 B.R. 493, 496-97 (Bankr. W.D. Mo. 1980) (adequate protection included, *inter alia*, periodic financial and operational reporting); *In re Sun TV and Appliances, Inc.*, Case No. 98-2107 (MJW) (Bankr. D. Del.) (adequate protection requirement that debtors timely file motion for approval of liquidator engagement and finalize agreement to conduct store closings).

C. THE RECEIVER’S CONTINUED MANAGEMENT AND ADMINISTRATION OF THE SYSTEM AND SYSTEM REVENUE IS EXEMPTED FROM THE AUTOMATIC STAY AS AN EXERCISE OF POLICE/REGULATORY POWER PURSUANT TO SECTION 362(b)(4) OF THE BANKRUPTCY CODE

14. While Syncora joins in the Receivership Motions, including to the extent they assert that the automatic stay pursuant to section 362 of the Bankruptcy Code is inapplicable to the Receiver’s rate-making authority pursuant to the Receiver Order, Syncora writes to

supplement the assertion that the Receiver's *management* and *administration* of the System are exempted from the automatic stay as an exercise of police and regulatory power pursuant to section 362(b)(4) of the Bankruptcy Code.

15. The Receiver's continued authority over the System constitutes a "police or regulatory power" protected from the automatic stay because such actions are in furtherance of the public health, safety, and welfare of the citizens of the County, and not to advance the Receiver's pecuniary interest in any of the County's property. *See In re Bevelle*, 348 B.R. 812, 819 (Bankr. N.D. Ala. 2006) (finding that condemnation of debtor's property was an exercise "in furtherance of public health, safety or welfare" and thus was captured by the exception of section 362(b)(4)); *In re Dolen*, 265 B.R. 471, 481 (Bankr. M.D. Fla. 2001) (police powers exception based upon whether the action at issue relates to a matter of public safety and health rather than primarily to the protection of the government's pecuniary interest in the debtor's property).

16. Alabama law makes clear that the administration of a sewer system, and the corresponding authority to generate sufficient revenues to operate the system, falls squarely within a municipality's police powers. *See St. Clair County Home Builders Ass'n v. City of Pell City*, 61 So. 3d 992, 1005-06 (Ala. 2010) (citing provisions of the Alabama Code and quoting *Board of Water & Sewer Comm'rs of the City of Mobile v. Yarbrough*, 662 So.2d 251, 254 (Ala. 1995)) ("Because a municipality has the authority under its police powers to control sanitary matters within its limits by operating a sewer system, it has the corresponding authority to generate sufficient revenues from its residents, the persons who benefit from it most, to carry out its undertaking to operate a sewer system.").⁹

⁹ Although municipalities generally are cities and towns, the Alabama Constitution provides for Jefferson County's authority over its sewage systems. *See* Ala. Const. Amend. No. 73.

17. The police and regulatory power over the System were placed in the Receiver pursuant to the Receiver Order. Alabama Code section 6-6-620 gave the State Court the authority to appoint the Receiver, and it was pursuant to this authority that the State Court entered the Receiver Order because, among other reasons, the County had “failed to operate the Sewer System in an economical, efficient and proper manner; and the *public interest and the ends of justice will be best served by the appointment of a receiver.*” (Receiver Order ¶ 17) (emphasis added). The County does not dispute that the Receiver Order granted the Receiver with sole and exclusive authority, possession, and control over the entire System and not only revenues generated by the System,¹⁰ thus instilling the Receiver with the public function of operating the System for the benefit of the citizens of the County as well as all other stakeholders.

18. The Receiver, having been appointed by the State Court, pursuant to state statute, is a “governmental unit” under Section 101(26) of the Bankruptcy Code, whose operation and administration of the System constitutes the enforcement of the police/regulatory power granted to it by the State. *See In re Piperi*, 133 B.R. 846, 849 (S.D. Tex. 1990) (holding that “receiver pursuant to state statute, of a state savings and loan association, falls within the category of a governmental unit,” and the receiver’s enforcement of the state’s regulatory power was excepted from the automatic stay pursuant to section 362(b)(4)); *Sec. & Exch. Comm’n v. First Fin. Group*

¹⁰ See County Letter at 2. The County, in a blatant effort to avoid the application of section 362(b)(4), attempts in its letter to narrowly define the Receiver’s responsibilities as being the pursuit of “payment and satisfaction of the Sewer Warrants and the money judgment contained in the Receiver Order.” *Id.* However, as noted above, the Receiver was appointed not only because of defaults with respect to the Bonds, but also to generally operate the System because the County had failed to do so properly and in accordance with the applicable law. Moreover, the Receiver’s powers are in no way limited to setting rates or managing incoming revenue. Indeed, the first of the Receiver’s several enumerated powers under the Receiver Order is “[t]he sole and exclusive right and authority to take complete and exclusive possession, control and custody of the System in order to operate and administer the System and to perform all acts necessary or desirable to administer and operate the System in the ordinary course of business.” (Receiver Order ¶ 2a.)

of Texas, 645 F.2d 429, 439 (5th Cir. 1981) (“An examination of the legislative history of section 362 . . . reveals that an ‘act to obtain possession’ was not intended to include the judicial appointment of a receiver pursuant to a governmental unit’s enforcement of its police or regulatory powers. . . .”). Thus, to the extent that the automatic stay otherwise would even apply, the Receiver’s administration of the System and control over related revenues is exempted therefrom as an exercise of police or regulatory powers by a governmental unit.

III. CONCLUSION

WHEREFORE, for the foregoing reasons, and for the reasons set forth in the Receivership Motions, Syncora respectfully requests that the Court enter an order consistent with the relief requested in the Receivership Motions, and any such other or additional relief the Court deems just and proper.

Dated: November 15, 2011
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CERTIFICATE OF SERVICE

I hereby certify that the foregoing Response and Memorandum of Supplemental Points of Syncora Guarantee Inc, etc. was filed and served via the Court's electronic case filing and noticing system to all parties registered to receive electronic notices in this matter, and via Electronic Mail and U.S. Mail First Class as hereafter set forth, this 15th day of November, 2011:

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